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No. 49

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1940

GUY T. HELVERING, Commissioner of Internal Revenue,

Petitioner,

v.

GODFREY HAMMEL AND PEARL HAMMEL

Respondent.

BRIEF FOR THE RESPONDENT

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Questions Presented

The statement under the above caption of Petitioner's Brief (p. 2) is to our mind not sufficiently definite. We believe it should be stated as follows:

The question presented is whether the loss to the Respondent, Pearl Hammel, is a loss resulting from the "sale or exchange" of the property in question and therefore within the purview of Section 117 (d) of the Revenue Act of 1934, or, whether the loss is an ordinary loss allowable as a deduction in full under and within the purview of Section 23 (e) (2) of the Revenue Act of 1934.

Summary of Respondent's Argument

The Respondent contends that her loss was not occasioned by a "sale or exchange" *by her,* but was a forcible taking away of her equitable interest in property by virtue of foreclosure proceedings; that this loss was occasioned by economic conditions and the identifiable event establishing that worthlessness was the foreclosure proceedings, the Sheriff's sale being merely the legal means devised to measure the damage to the plaintiff and without which it would not be possible to ascertain that damage which is based on the rule of the difference between the balance owing on the contract and the fair market value of the property.

The Respondent further contends that Section 117 (d) of Revenue Act of 1934 relates solely to "sales and exchanges" of capital assets made by the taxpayer voluntarily, the words "sales and exchanges" being used in their ordinary connotation.

Respondent's Argument

A.

THE PURPOSE OF SECTION 117 IS IN GREAT PART TO PREVENT TAX AVOIDANCE.

It seems quite evident that Section 117 of the Revenue Act of 1934 was mainly designed to prevent tax avoidance by the deliberate or voluntary act of taxpayers, such as sales of stock or investments by a taxpayer for the

purpose of establishing a loss during a certain taxable year, and that it was never intended to cover a transaction in which a taxpayer sustains an involuntary bona fide loss through legal action depriving or divesting him of his property through due process of law.

In this connection we wish to call this Court's attention to House Report No. 1388 of the House Ways and Means Committee on H. R. 13,770, 67th Cong. 4th Session, and to the same account as set forth in Petitioner's Appendix B.

> "Our present system has the following defects: * * * Third: Taxpayers *take their loss* within the two year period and get full benefit therefrom, and *delay taking gains* until the two year period has expired thereby reducing their taxes."

Among the purposes of the Section the following is set forth:

> "Fourth: To prevent *tax avoidance* in the case of capital losses * * *. The changes made are either to prevent *tax avoidance* or to bring about *greater equity.*"

If Congress had intended a "sale or exchange" in Section 117 to include and cover losses suffered through foreclosure, it would have made a provision similar to the provisions of Sections 117 (e) (1) and (2) and (f) wherein "short sales" and gains or losses attributable to the failure to exercise privileges or options to buy or sell and amounts received by the holder upon the retirement of bonds, etc., though not normally within the ordinary definition of a "sale or exchange," are expressly ordered to be *considered* as gains or losses from "sales or exchanges" of capital assets.

Petitioner, in his "summary of argument" (Petitioner's Brief, p. 6) mentions the Revenue Act of 1938, with particular reference to losses from worthless securities having been expressly subjected by that Act to the capital gain and loss provisions. (Petitioner is we believe referring to Section 23 (g) (2) of the Revenue Act of 1938). He goes on to argue as follows:

> "If Congress had thought that the phrase 'sales or exchanges,' as theretofore used, had included only voluntary transactions, it probably would have expressly broadened the scope of the phrase as used in Section 117 of the 1938 Revenue Act, which it did not do."

We submit that this is not a correct deduction or inference. On the contrary, Congress having used the phrase "sales or exchanges," and having in mind the ordinary meaning of the word "sale" and of the word "exchange", expressly provides in both the 1934 Act and the 1938 Act that certain losses, which otherwise did not come within the term "sale or exchange," are *to be considered* as losses from "sales or exchanges."

This is manifest from Section 117 (e) (1) and (2) and (f) of the 1934 Revenue Act, and Section 23 (g) (2) of the 1938 Act.

That Congress must be deemed to have used the words in their ordinary signification needs no argument. *Williamson v. Berry*, 49 U. S. 495, 12 L. Ed. 1170.

Is it not, therefore, a more logical assumption that if Congress had intended that a forced divestiture of ownership of property should be considered a "sale or exchange" it would have expressly included such transaction under Section 117 or made it another exception to Section 23

by express provision, as it did with regard to the transactions above referred to.

It is significant also that Congress in enacting Section 111 of the Revenue Act of 1934 (Appendix A, Pet. Brief) used the following language:

> "The gain from the sale *or other disposition* of property shall be the excess of the amount realized therefrom * * *."

Here Congress realizing the limitations of the word "sale" expressly broadened the statute.

An excellent argument for our position is found in *Commissioner v. Freihofer,* 102 F. (2d) 787 (3d Cir.) wherein the Court said:

> "These statements which were quoted with approval by the Finance Committee of the Senate in its report upon the Bill (Senate Report No. 558, 73rd Cong. 2d Session), show quite convincingly that *it was the intent of the Congress to deal in Section* 117 *with gains and losses resulting from the voluntary sale of capital assets.* The Committee said that the plan of taxation contained in the Act was 'to measure the gain or loss from the sale of property *by an individual* according to the length of time *he has held* the property.' It would be difficult to find a clearer statement of the Congressional intent than this. We think it compels the conclusion that the sale of capital assets referred to in Section 117 are those sales only which are *voluntarily* made by a taxpayer and that *judicial sales made by the Sheriff in execution of a judgment in a proceeding for the foreclosure of a mortgage given by a prior owner are not included.*" (Italics, ours.)

Persuasive also are the excerpts from the Congressional discussion set forth in the Appendix of this brief.

Tax avoidance is almost invariably the result of the planned, voluntary act of the taxpayer. Prior to the passage of Section 117 of the Revenue Act of 1934, it was legally permissible for a taxpayer to minimize his income tax by deliberately selling stocks or other capital assets at a loss, and taking a full deduction for the loss thus established. Congress, in its desire to place as many restrictions as possible on this practice, enacted Section 117, among other provisions. Nowhere in the Act can there be found any language whatsoever to justify an inference that Congress intended anything else. Nowhere in the Act can there be found language to indicate the placing of any restrictions upon the right of the taxpayer to take full deduction for losses suffered over which he had no control, except as expressly stated in the Act, Sec. 117 (e) and (f).

That this loss was involuntary is not questioned. The proceedings were had in open court in Oakland County and appealed therefrom to the Supreme Court of the State of Michigan. The respondent's property was first foreclosed. This was followed by the Sheriff's sale, as required by law, in order that the seller might determine the amount of the deficiency and have a decree therefor against the respondent. The sheriff acted as the agent of the law (24 R.C.L., 912) and at the instance of Mrs. Julia Adams, the Seller in the land contract, she being the person whose interests were directly and completely adverse to the interests of respondent Pearl Hammel. It was not sold by the respondent. It was not a sale or exchange by the respondent, the entire proceeding being one over which the respondent had no control. Her interest in the property was "extinguished", not sold.

Nowhere in his brief does Petitioner contend that Respondent was a party to or consented to the Sheriff's sale. On the contrary he seems to concede this point. (Petitioner's Brief, p. 5.)

B.

A SALE OR EXCHANGE UNDER SECTION 117 MEANS A VOLUNTARY SALE BY THE TAXPAYER.

Inasmuch as the vital question in this case is whether the Respondent's loss was due to a "sale or exchange" within Section 117 the definitions of these words in common usage and in definitions by the Courts are of importance.

> "A sale is a contract whereby one acquires a property in the thing sold and the owner parts with it for a valuable consideration." (Words and Phrases, Vol. 4, p. 437.)
>
> "A sale is generally understood to mean the transfer of property for money." (Id. p. 441).
>
> "Sale, in the ordinary sense means transfer of property for a fixed price in money or its equivalent. * * * A sale is a contract whereby one acquires a property in the thing sold and the owner parts with it for a valuable consideration." (*Hale v. Helvering*, 85 F. (2d) 819.)

In *Pinellas Ice & Cold Storage Co.*, 21 BTA, 425, the Board states the rule laid down and recognized by this Court as to what constitutes a sale as expressed in the case of *Williamson v. Berry*, supra:

> "We remark that 'sale' is of precise legal import both at law and in equity. It means at all times a contract between parties, to give and to pass rights of property for money which the buyer

pays, or promises to pay, the Seller for the thing bought. * * * Congress should be presumed to have a knowledge of the law as laid down by the Supreme Court, long recognized as to what constitutes a sale, and we must assume that the language used in Section 203 was used in that import, especially since the Section of the Statute involved used both the words 'sale' and 'exchange'."

The opinion of the Third Circuit in the instant case aptly phrases the definition of "sale" in the following language:

> "Sale is a word of precise legal import. Its elements are (1) parties competent to contract; (2) mutual consent; (3) a thing, the absolute or general property in which is transferred from the seller to the buyer; (4) a price in money paid or promised. (*Bullen v. Thompson*, 92 U. S. 412, 414; *Williamson v. Berry*, supra.) There is nothing in the legislative history of the statute in question or in the language of the Act indicating that the Congress used the word 'sale' in any sense other than its precise legal import or plain and obvious meaning. If any one of the above elements be absent, it is not a sale as that word is understood in its ordinary signification." *Commissioner v. Hammel*, 108 F (2d) 753.

Again, in *Commissioner v. Freihofer*, 102 F. (2d) 787 (3rd Cir.), the Court said:

> "Blackstone defined a sale as 'a transmutation of property from one man to another in consideration of some price or recompense in value' 2 Bl. 446. It is a contract for the transfer of property from one person to another for a valuable consideration. See 7 Words and Phrases, First series, Sale, page 6291. There must be parties standing to each other in the relation of buyer and seller, their minds must assent to the same proposition, and a consid-

eration must pass. *Butler v. Thomson,* 92 U. S. 412, 23 L. Ed. 684. Where the word is used, in the absence of anything to the contrary it will be assumed that the word is intended to have its usual signification. *De Ganay v. Lederer,* 250 U. S. 376, 39 S. Ct. 524, 63 L. Ed. 1042; *State v. Colonial Club,* 154 N. C. 177, 69 S. E. 771, 31 L.R.A.N.S., 376, Ann. Cas. 1912A, 1079. That signification includes voluntary action by the owner and a consideration. Here the taxpayer, the owners of the properties involved in the foreclosures, were not parties to the sheriff's sales, nor did they receive any part of the price obtained at those sales. These were, therefore, not sales in the ordinary sense. On the contrary they were adverse judicial proceedings whereby the titles of the taxpayers were extinguished, as we shall presently point out, without any recompense."

In *Mont Echols,* 24 BTA, 1127, the Board states:

"On the other hand, we cannot find in the capital gain and loss provision of the Act, *nor in the legislative history* of their enactment, any intent to include in capital losses, losses sustained by capital assets merely becoming worthless. The intent there is clearly to allow as capital losses only those occuring from 'sale or exchange' of capital assets. Losses due to such assets becoming worthless being covered by the ordinary loss provision allowing their deductions from income other than that represented by capital gain." (Italics ours.) See also *Dallas Transfer & Terminal Warehouse Company v. Com.,* 70 F (2d) (20) 95.

We submit that the foregoing decisions conclusively establish

(a) that the phrase "sale or exchange" as used in the Act is to be taken in its ordinary connotation;

(b) that a *sine qua non* of a "sale or exchange" is the volition of the seller and his consequent participation as one of the parties to the transaction, and

(c) that the words exclude any taking away or divesting of the property of an owner by process of law, in which instance the owner's consent is lacking.

There seems to be no contention that the transaction here involved constitutes an "exchange" and we content ourselves with but two definitions:

> "Exchange is defined as a mutual grant of equal interest, the one in consideration of the other." (Hale v. Helvering, supra).
>
> "Exchange is a mutual transfer of property other than for money."
>
> (Law v. McLaughlin, 2 F, Supp. 601, 603).

The Board of Tax Appeals has consistently held transactions like the present not to be "sales or exchanges." Characteristic decisions are the following:

> *Warfield v. Comm.*, 38 B. T. A., 907;
> *Rust, Jr. v. Comm.*, 38 B. T. A., 910;
> *Hill v. Comm.*, 40 B. T. A., 376;
> *Ganopuls v. Comm.*, 39 B. T. A., 1120;
> *Nebraska Bridge etc. Co. v. Comm.*, 40 B. T. A., 40;
> *Hoffman v. Comm.*, 40 B. T. A.
> *Gransden v. Comm.*, 39 B. T. A. 985.

Under the above definitions and decisions, to whom did Mrs. Hammel part with her interest in this property for a valuable consideration?

To whom did she give title?

What was the value or consideration passing to her?

If, as stated in *U. S. v. Benedict,* 280 Fed. 76, 80, the word "sale" in its ordinary sense means a transfer of property for a fixed price in money or its equivalent, where was the transfer of property and where was the money or its equivalent passing to Mrs. Hammel?

Congress is presumed, under the decisions, to use certain words in their ordinary meaning. Can this Court, by any stretch of the imagination, decide that Mrs. Hammel sold this property? Can the Court say this was a sale? To give a practical illustration: Suppose a person has lost his home by foreclosure and after the foreclosure is complete, testifies in court that he sold his home. Would he be telling the truth or would he be telling a falsehood? To call the transaction, which actually took place here, a sale or exchange is straining the word "sale" and the word "exchange" beyond any meaning that we have ever read of or heard of.

An "exchange" is a mutual grant of equal interest, the one in consideration of the other (*Hale v. Helvering.*) If this transaction be a mutual grant of equal interest, then the words "mutual" and "grant" are clearly dragged out of their proper sphere of meaning to suit the wishes of the petitioner. There was no grant on the part of the respondent. She gave no deed. She gave no assignment, nor did the vendor in the contract give anything whatsoever to the respondent. The respondent's property *was taken from her. It was foreclosed.* It was *not sold.* It was *not exchanged,* and she received nothing whatsoever. Her interest was "extinguished", not sold. The deficiency judgment against her was, of course, less by the amount of the bid at the

Sheriff's sale, but that does not mean that the respondent received anything.

We are not claiming the deficiency judgment, amounting to $79,000.00, *as a loss,* and we direct the Court's attention to the fact that, regardless of the amount of the deficiency judgment, the loss was the amount of money she paid on the contract, to-wit: $4,998.03, *and that amount was not in any way affected by the amount of the deficiency judgment.*

Where was there any mutual grant of equal interest?

What grant of any equal interest passed to Mrs. Hammel in this transaction?

What grant was made by Mrs. Hammel for an equal interest?

It is only by a *violent straining of the language,* and by *ignoring the purposes* of Section 117 that the taxpayer could be held to have been a participant in either a "sale or an exchange."

Lynch v. Alworth-Stephens Co., 267 U. S. 364-370 (45 S. Ct. 274, 69 L. Ed. 660) holds:

> "The plain, obvious and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and the ingenuity and study of an acute and powerful intellect would discover."

This is the rule applied to the taxing acts.

See also *Burkett v. Comm.,* 31 F (2d) 667 and *Burnet v. Harmal,* 287 U. S. 103, 74 L. Ed. 199.

What occurred was exactly this: The Seller in the land contract decided to reposses herself of her property, commenced foreclosure proceedings against the Syndicate owners (respondent being one of them) and obtained a decree of foreclosure authorizing a public sale to determine whether any deficiency existed upon which a deficiency judgment or decree could be based against the Syndicate members. The Syndicate members were unable to pay. Therefore, what happened was: a *forcible, legal taking away* of the Syndicate Members' rights to the property *without their consent* and, as a matter of fact, against their active opposition in Court. It is stipulated that in the year 1934, Respondent lost her interest in this property. (R. p. 13).

We are aware that in *Commissioner v. Electro-Chemical Co.*, 110 F. (2d) 614, the Court takes the position that if it is held that Section 117 pertains only to voluntary sales by the taxpayer, connivance between a seller and a purchaser, or between a mortgagor and mortgagee, or between a client and his broker, could deprive the government of revenues. Petitioner in his Brief (p. 25) says substantially the same thing.

Since when are the Courts justified in a forced or unnatural construction of a statute for such a reason. By the same specious reasoning even prayer to the Almighty could be condemned just because men have occasionally become crazed through incessant and inordinate recourse to that medium of communication with their Creator.

We take it that the bona fides of every transaction which comes under the scrutiny of the Internal Revenue Department is established to the satisfaction of the department or of the Courts before the taxpayers contention is allowed to prevail. There can be no question of

the honesty and good faith of the transaction here in issue. No question has ever been raised in this case on such grounds at any stage of a long drawn out process of litigation.

The Electro-Chemical case recites that the proceeds of the mortgage foreclosure sale "must be deemed in full satisfaction of the mortgage debt and no right to recover any deficiency in any action or proceeding shall exist." This because the owner of the mortgage did not attempt to enforce the deficiency against the taxpayer. In the instant case the taxpayer was forced into bankruptcy to escape collection of the deficiency.

We submit that the opinion last referred to is not the correct solution of the legal problem there in issue.

C.

THE LOSS OF RESPONDENT WAS DUE TO ECONOMIC CONDITIONS WHICH MADE HER INTEREST WORTHLESS AND THE FORECLOSURE DECREE WAS THE IDENTIFIABLE ACT WHICH MERELY PROVED RESPONDENT'S LOSS.

In order that we may properly approach the question whether the loss of Respondent was brought about or resulted from the "sale or exchange" of her interest in the property within the meaning of Section 117 of the 1934 Revenue Act, it is well to inquire what was the exact situation confronting her immediately prior to the trial of the foreclosure action.

According to the Stipulation of Facts (R. pp. 12-14), the syndicate of which the Respondent was a member purchased the land here in question on land contract, the purchase price being $96,000.00. Including the down pay-

ment, $24,000.00 had been paid on principal by 1934, leaving an unpaid principal balance in 1934 of $72,000.00, plus interest and State and County taxes for several years.

Because of the general financial condition of the country the total value of this land receded to the value of ordinary farm land and its market value in 1934 was approximately $8,000.00 instead of $96,000.00 which was the contract price. (Stipulation of Facts, R. pp. 12 and 13).

The members of the syndicate, including the Respondent, were unable to meet the payments called for by the contract and were in default.

It is apparent that the interest of the syndicate members under this contract in 1934 immediately prior to foreclosure proceedings was entirely worthless. Considering that the total property was worth $8,000.00, nevertheless the interest of the syndicate members, inasmuch as they owed a balance of over $72,000.00, must have been utterly worthless, and it is impossible to conceive of anyone being willing to pay any sum whatsoever for the interest of the syndicate members under their contract.

If the estate of A has assets of $8,000.00 and liabilities of $72,000.00, what is A's estate worth, or what is its fair market value? Precisely nothing minus. The estate is insolvent.

This answers the argument of Petitioner on the subject of worthlessness. (Petitioner's Brief, p. 13).

Petitioner states (Pet. Brief p. 12) that worthlessness of the property was not advanced by the Respondent in

this case. That question has always been and now is in the case. (See Petition for Redetermination, par. 8, R. p. 3).

Her interest being worthless, it would have been to the advantage of respondent to abandon the property, and had she abandoned it, even with the consent of the seller, and had she been able to establish in Court proceedings the finality of that abandonment, she would have been entitled, under Section 23 (e) (2), to deduct the loss in full for the year 1934.

It is a fair and logical assumption, well within the stipulation of facts, to conclude that Respondent was not allowed, so far as the seller was concerned, to abandon her interest, because the seller commenced foreclosure proceedings in which she sought to take away respondent's interest in the property and to obtain a deficiency judgment. By the decree, the Court found that the syndicate members were indebted to the plaintiff for the full unpaid balance and interest evidenced by said contract and ordered payment thereof, and provided that in default of said payment the land be sold at public auction.

The foreclosure sale did not occasion that worthlessness and it did not occasion that loss. World wide circumstances ante-dating the foreclosure sale was the factor because of which this Respondent had lost whatever she had put into the property.

It is stipulated that the decree of foreclosure gave no right of redemption. Therefore, the decree itself became immediately the identifiable act which conclusively established the fact of loss in the year 1934. It is stipulated that the total land purchased was worth in 1934 only $8,000.00. It is stipulated that the plaintiff obtained

a deficiency judgment against all members of the syndicate, jointly and severally, of approximately $79,000.00. Unless we are to indulge in the violent assumption that land concededly worth only $8,000.00 might bring at a sale $79,000.00, it became definitely established the moment the decree was signed that the entire investment by the members of the syndicate, including this Respondent, was utterly wiped out. The sale which the decree ordered, was and always is, designed solely for the purpose of determining the amount in which the defendant is to be penalized in addition to the loss of defendant's interest in the property.

A foreclosure sale is, therefore, merely a part of the machinery through which a vendor, bringing action in equity for foreclosure of the vendor's lien and deficiency decree may have determined the exact amount of that defeciency, a sale being the only means of making effective the rule that the vendor is entitled to the difference bebetween the balance due upon the contract and the fair market value of the property. As was said in *Chicago Boulevard Land Company v. Apartment Garages*, 245 Mich. 448-450:

> "The contract contained the *usual provision* that on default of the vendee the vendor had the right to declare the contract void, retain moneys paid and improvements and re-take possession. * * * On vendee's default in a land contract containing the usual foreclosure clause, vendor may treat the contract as continuing in force and sue at law upon it for payments due, or bring action in equity for foreclosure of the vendor's lien and deficiency decree; or he may declare it forfeited."

Now, the type of land contract in question here is not described in the stipulation of facts. The instrument is

described merely as a land contract. Had there been any question in the minds of either party at the time of the stipulation that the type of land contract mattered, it would have been very easy either to describe it in the stipulation or to set it forth in full. It is evident, therefore, we submit, that it was the usual form of land contract and, as stated above, a forfeiture provision is a usual provision in land contracts in Michigan. And we submit, therefore, that it should be presumed that the vendor in this case had the right to declare a forfeiture if she so wished.

However, once the vendor declares a forfeiture she is forever barred from suing upon the contract either at law or in equity for payments due. (*Chicago Boulevard Land Co. v. Apartment Garages,* supra.)

If Petitioner's argument is sound, then one who is deprived of his land contract interest by a notice of forfeiture (there being no sale under such a proceeding) may take a deduction in full under Section 23 of the Revenue Act of 1934.

However, if the purchaser (helpless in the matter), is subjected to an equity foreclosure, he loses his interest and in addition suffers a deficiency decree which may (and in this case did) result in bankruptcy.

Then merely because his property, without his consent, is sold by the Sheriff or Commissioner, he is limited in the amount of loss he may claim in his income tax return by the provisions of Section 117.

Why the additional hardship placed upon the one who suffers the greater misfortune?

Despite Petitioner's argument, it follows that the Sixth Circuit was correct when, in its opinion, in the instant case it said:

> "It follows that the vendor here in question had the right to deprive the Respondent and her joint adventurers of all interest in the property by a declaration of forfeiture and the only additional advantage of foreclosure was to obtain a deficiency judgment. (*Commissioner v. Hammel,* supra.)

While it may be beside the point, even had there been a period of redemption allowed the Respondent after the foreclosure sale, the loss would not have arisen from the sale. The loss would then have been determined by the expiration of the period of redemption, and again the sale would merely have been the measuring stick of the damages of the vendor. (*Commissioner v. Hawkins,* 91 F. (2d) 354.

We submit, therefore, that by no process of reasoning can it be said that this was a loss arising from the sheriff's sale.

Petitioner needlessly argues that a Sheriff's sale is a sale. Certainly it is a sale, but it is not a sale by the taxpayer, and it is not a sale within Section 117 of the Revenue Act of 1934.

Petitioner devotes considerable attention to the nature of the interests which are created upon the execution of a land contract, and with his conclusions we have very little quarrel. The cases cited by him establish the fact that while the vendor still retains the legal title, the vendee has the equitable title and consequently the beneficial ownership, including the right to possession, and the right to the rents and profits and the power, unless

expressly forbidden by the terms of the contract, to transfer those rights to others. We concede that the so-called beneficial ownership of the Respondent under land contract was a capital asset and that consequently her loss was the loss of a capital asset. But to argue, as Petitioner does, that because the Respondent had the right to sell or otherwise dispose of her beneficial ownership or interest, and that that interest and the property in which the interest lay was sold at a Sheriff's foreclosure sale that, therefore, the loss arose from the sale, is a complete *non sequitur*. (Petitioner's brief, pp. 7-8).

Whether the Sheriff's sale disposed of the property, or of the Respondent's beneficial interest therein, or whether that sale was a sale of the equitable title of the vendee is unimportant, because as a matter of hard fact the loss was occasioned by economic conditions beyond the control of the Respondent which rendered her interest worthless. The foreclosure was merely the identifiable event which established her loss. She was deprived of her interest in the property not by sale but, as was said by the Sixth Circuit, by an adverse judicial proceeding which completely extinguished her title without consideration.

Conclusion

It is apparent that this transaction insofar as Respondent is concerned was not a sale or exchange of property; that the loss was not the result of any voluntary act upon the part of the Respondent, and that it was the result of Respondent's interest becoming worthless, which worthlessness was merely proven by the foreclosure proceedings.

Respondent's loss, therefore, is in the same category as any loss over which a taxpayer has no control, such as those losses which are due to the act of God, casualty, or assets becoming worthless, which are the types of loss contemplated by and within the purview of Section 23 of the 1934 Act. That Section also provides, under subsection (e) (2) thereof, that losses by individuals, if incurred in *any* transaction entered into for profit, though not connected with a trade or business, are deductible in full.

We respectfully submit that the opinion of the Circuit Court of Appeals is correct and should be affirmed.

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Dated: Nov. 2, 1940.

Appendix

CONGRESSIONAL DISCUSSION (House)
(Cong. Rec. Vol. 78)

Mr. Cooper of Tennessee. * * * Under existing law there are only two types of capital gains and losses treated under the income tax law. We will consider for a moment a capital gain-or-loss transaction. If the asset has been held for less than 2 years it is treated in full as ordinary income. The full amount is taken by way of tax on the gain and a full amount given by way of loss on the loss sustained. But if the asset is held over 2 years there is a rate of 12½ percent applied to the capital gain or the capital loss. This simply means that many *wealthy taxpayers* of this country *dispose* of their capital assets in order to get the benefit of the loss by selling just before the 2-year period expires and the gain *by selling* just over the 2-year period. Your committee, after giving most thoughtful attention to the subject, decided that there should be a further extension or division of the period of time within which treatment should be given to these capital gains or losses. (P. 2789).

CONGRESSIONAL DISCUSSION (House)
(Cong. Rec. Vol. 78)

Mr. Arnold. Then if I should hold some stocks for a period of 2 years and *I should sell* that stock at a loss and I did not have any income to offset that from other stocks, would I entirely lose the benefit of that credit?

Mr. Samuel B. Hill. You would lose it entirely.

Mr. Vinson of Kentucky. May I suggest that under the existing law you lose the right *to take a loss* on the sale of stock against an ordinary gain?

Mr. Arnold. Under existing law?

Mr. Vinson of Kentucky. That was put into the 1932 Revenue Act.

Mr. Samuel B. Hill. The committee feels *it has absolutely plugged that avenue* through which taxes were escaping *by manipulation of capital investments, purely for the purpose of creating paper losses in order that they might offset those losses against ordinary income, and thereby reduce the taxes of the taxpayer.* I think we have completely blocked that loophole of tax escape, and that is one of the large leaks we had to deal with. (P. 2663).

CONGRESSIONAL DISCUSSION (House)
(Cong. Rec. Vol. 78)

Mr. Harrison. * * * The attention of the taxpayers of the United States has, however, been directed to numerous instances of wealthy individuals who have completely eliminated their income taxes *by taking losses* on sales of stock made to members of the taxpayer's family or to business associates. Frequently the taxpayer has reacquired the securities within a short time after the sale. In other words, *the sale was simply for the purpose of taking a tax loss;* and in many instances, after the transaction was concluded, the taxpayer held precisely the same property as before.

(Italics ours)

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SUPREME COURT OF THE UNITED STATES.

No. 49.—October Term, 1940.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Godfrey Hammel and Pearl Hammel. } On Writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

[January 6, 1941.]

Mr. Justice Stone delivered the opinion of the Court.

We are asked to say whether a loss sustained by an individual taxpayer upon the foreclosure sale of his interest in real estate, acquired for profit, is a loss which, under § 23(e)(2) of the 1934 Revenue Act, 48 Stat. 680, may be deducted in full from gross income for the purpose of arriving at taxable income, or is a capital loss deductible only to the limited extent provided in §§ 23(e)(2), (j), and 117.

In the computation of taxable income § 23(e)(2) of the 1934 Revenue Act permits the individual taxpayer to deduct losses sustained during the year incurred in any transaction for profit. Subsection (j) provides that "losses from sales or exchanges of capital assets" shall be allowed only to the extent of $2,000 plus gains from such sales or exchanges as provided by § 117(d). By § 117(b) it is declared that "capital assets" "means property held by the taxpayer . . . but does not include stock in trade of the taxpayer . . . or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

Respondent taxpayers, with other members of a syndicate, purchased "on land contract" a plot of land in Oakland County, Michigan, for the sum of $96,000, upon a down payment of $20,000. The precise nature of the contract does not appear beyond the fact that payments for the land were to be made in installments, and the vendor retained an interest in the land as security for payment of the balance of the purchase price. Before the purchase price was paid in full the syndicate defaulted on its payments. The vendor instituted foreclosure proceedings by suit in equity in a state court which resulted in a judicial sale of the property, the vendor be-

coming the purchaser, and in a deficiency judgment against the members of the syndicate. Respondents' contribution to the purchase money, some $4,000, was lost.

The commissioner, in computing respondents' taxable income for 1934, treated the taxpayers' interest in the land as a capital asset and allowed deduction of the loss from gross income only to the extent of $2,000 as provided by §§23(j) and 117(d), in the case of losses from sales of capital assets. The Board of Tax Appeals ruled that the loss was deductible in full. The circuit court of appeals affirmed, 108 F. (2d) 753, holding that the loss established by the foreclosure sale was not a loss from a "sale" within the meaning of § 23(j). We granted certiorari, 310 U. S. 619, to resolve a conflict of the decision below with that of the court of appeals for the second circuit in *Commissioner* v. *Electro-Chemical Engraving Co.*, 110 F. (2d) 614.

It is not denied that it was the foreclosure sale of respondents' interest in the land purchased by the syndicate for profit, which finally liquidated the capital investment made by its members and fixed the precise amount of the loss which respondents seek to deduct as such from gross income. But they argue that the "losses from sales" which by § 23(j) are made deductible only to the limited extent provided by § 117(d) are those losses resulting from sales voluntarily made by the taxpayer, and that losses resulting from forced sales like the present not being subject to the limitations of § 117(d) are deductible in full like other losses under § 23(e)(2).

To read this qualification into the statute respondents rely on judicial decisions applying the familiar rule that a restrictive covenant against sale or assignment refers to the voluntary action of the covenantor and not to transfers by operation of law or judicial sales *in invitum*. See *Guaranty Trust Co.* v. *Green Cove & M. R. Co.*, 139 U. S. 137; *Gazlay* v. *Williams*, 210 U. S. 41; *Riggs* v. *Purssell*, 66 N. Y. 193. But here we are not concerned with a restrictive covenant of the taxpayer, but with a sale as an effective means of establishing a deductible loss for the purpose of computing his income tax. The term sale may have many meanings, depending on the context, see Webster's New International Dictionary. The meaning here depends on the purpose with which it is used in the statute and the legislative history of that use. Hence the respondents argue that the purpose of providing in the 1934 Act for a special treatment of gains or losses from capital assets was to pre-

vent tax avoidance by depriving the taxpayer of the option allowed to him by the earlier acts, to effect losses deductible in full by sales of property at any time within two years after it was acquired, which until held for that period was not defined as a capital asset, § 208 Revenue Act of 1924, 43 Stat. 253; § 208 Revenue Act of 1926, 44 Stat. 19, and § 101 of the Revenue Act of 1928, 45 Stat. 811.

It is said that since losses from foreclosure sales not within the control of the taxpayer are not within the evil aimed at by the 1934 Act, they must be deemed to be excluded from the reach of its language. To support this contention respondents rely on the report of the Ways and Means Committee submitting to the House the bill which, with amendments not now material, became the Revenue Act of 1934. The Committee in pointing out a "defect" of the existing law said: "Taxpayers take their losses within the two year period and get full benefit therefrom and delay taking gains until the two-year period has expired, thereby reducing their taxes". H. Rept. 704, 73d Cong., 2d Sess., pp. 9 and 10.

But the treatment of gains and losses from sales of capital assets on a different basis from ordinary gains and losses was not introduced into the revenue laws by the 1934 Act. That had been a feature of every revenue law beginning with the Act of 1921, 42 Stat. 227, and each had defined as capital losses "losses from sales or exchanges of capital assets". The 1934 Act made no change in this respect but for the first time it provided that "capital assets" should include all property acquired by the taxpayer for profit regardless of the length of time held by him and that capital gains and losses from sales of capital assets should be recognized in the computation of taxable income according to the length of time the capital assets are held by the taxpayer, varying from 100% if the capital asset is held for not more than a year to 30% if it is held more than ten years. § 117(a). Finally, for the first time, the statute provided that capital losses in excess of capital gains should be deducted from ordinary income only to the extent of $2,000. Thus by treating all property acquired by the taxpayer for profit as capital assets and limiting the deduction of capital losses in the manner indicated, the Act materially curtailed the advantages which the taxpayer had previously been able to gain by choosing the time of selling his property.

The definition of capital losses as losses from "sales" of capital assets, as we have pointed out, was not new. As will presently appear, the legislative history of this definition shows that it was not chosen to exclude from the capital assets provisions losses resulting from forced sales of taxpayers' property. And, if so construed, substantial loss of revenue would result under the 1934 Act, whose purpose was to avoid loss of revenue by the application of the capital assets provisions. In drafting the 1934 Act the Committee had before it proposals for stabilizing the revenue by the adoption of the British system under which neither capital gains nor losses enter into the computation of the tax. In declining to follow this system in its entirety the Committee said: "It is deemed wiser to attempt a step in this direction without letting capital gains go entirely untaxed". It accordingly reduced the tax burden on capital gains progressively with the increase of the period up to ten years, during which the taxpayer holds the capital asset, and permitted the deduction, on the same scale, of capital losses, but only to the extent that there are taxable capital gains, plus $2,000. In thus relieving capital gains from the tax imposed on other types of income, it cannot be assumed, in the absence of some clear indication to the contrary, that Congress intended to permit deductions in full of losses resulting from forced sales of the taxpayers' property, from either capital gains or ordinary gross income, while taxing only a fraction of the gains resulting from the sales of such property. See *White* v. *United States*, 305 U. S. 281, 292; *Helvering* v. *Inter-Mountain Life Ins. Co.*, 294 U. S. 686, 689, 690.

The taxation of capital gains after deduction of ~~taxable~~ capital losses on a more favorable basis than other income, was provided for by § 206 of the 1921 Revenue Act, as the means of encouraging profit-taking sales of capital investments, H. Rept. No. 350, 67th Cong., 2d Sess., p. 8. *Burnet* v. *Harmel*, 287 U. S. 103, 106. In this section, as in later Acts, capital net gain was defined as "the excess of the total capital gain over the sum of capital deductions, and capital losses"; capital losses being defined as the loss resulting from the sale or exchange of capital assets. In submitting the proposed Revenue Act of 1924, the House committee pointed out that the 1921 Act contained no provision for limiting deduction of capital losses where they exceeded the amount of capital gains. H. Rept. No. 179, 68th Cong., 1st Sess., p. 14. This was remedied by providing in § 208(c)

that the amount by which the tax is reduced on account of a capital loss shall not exceed 12½% of the capital loss. In commenting on this provision the Committee said, p. 10: "If the amount by which the tax is to be increased on account of capital gains is limited to 12½% of the capital gain it follows logically that the amount by which the tax is reduced on account of capital losses shall be limited to the 12½% of the loss." This provision was continued without changes now material until the 1934 Act. § 208(c) in the 1924 and 1926 Acts; § 101(b) in the 1928 and 1932 Act, 47 Stat. 191.

Congress thus has given clear indication of a purpose to offset capital ~~assets~~ gains by losses from the sale of like property and upon the same percentage basis as that on which the gains are taxed. See *United States* v. *Pleasants,* 305 U. S. 357, 360. This purpose to treat gains and deductible losses on a parity but with a further specific provision provided by § 117(d) of the 1934 Act, permitting specified percentages of capital losses to be deducted from ordinary income to the extent of $2,000, would be defeated in a most substantial way if only a percentage of the gains were taxed but losses on sales of like property could be deducted in full from gross income. This treatment of losses from sales of capital assets in the 1924 and later Acts and the reason given for adopting it afford convincing evidence that the "sales" referred to in the statute include forced sales such as have sufficed, under long accepted income tax practice, to establish a deductible loss in the case of non-capital assets. Such sales can equally be taken to establish the loss in the case of capital assets without infringing the declared policy of the statute to treat capital gains and losses on a parity.

We can find no basis in the language of the Act, its purpose or its legislative history, for saying that losses from sales of capital assets under the 1934 Act, more than its predecessors, were to be treated any differently whether they resulted from forced sales or voluntary sales. True, courts in the interpretation of a statute have some scope for adopting a restricted rather than a literal or usual meaning of its words where acceptance of that meaning would lead to absurd results, *United States* v. *Katz,* 271 U. S. 354, 362, or would thwart the obvious purpose of the statute, *Haggar* v. *Helvering,* 308 U. S. 389. But courts are not free to reject that meaning where no such consequences follow and where, as here, it appears to be consonant with

the purposes of the Act as declared by Congress and plainly disclosed by its structure.

It is not without significance that Congress, in the 1934 Act, enlarged the scope of its provisions relating to losses from sales of capital assets by including within them losses upon the disposition of the taxpayer's property by methods other than sale and without reference to the voluntary action of the taxpayer. It thus treats as losses from sales or exchanges the loss sustained from redemption of stock, § 115(c), retirement of bonds, § 117(f), losses from short sales, § 117(e)(1), and loss sustained by failure of the holder of an option to exercise it, § 117(e)(2), although none of these transactions involves a loss from a sale. See *McClain* v. *Helvering*, No. 55, decided this day.

The scope of the capital loss provisions was still further enlarged by § 23(k)(2) of the Revenue Act of 1938, 52 Stat. 447, which provides that if securities, which are capital assets, are ascertained to be worthless and are charged off within the taxable year the loss, with an exception not now material, shall be considered as a loss arising from a sale or exchange. These provisions disclose a consistent legislative policy to enlarge the class of deductible losses made subject to the capital assets provisions without regard to the voluntary action of the taxpayer in producing them. We could hardly suppose that Congress would not have made provision for the like treatment of losses resulting from a forced sale of the taxpayer's property acquired for profit either in the 1934 or 1938 Act, if it had thought that the term "sales or exchanges" as used in both acts did not include such sales of the taxpayer's property.

Respondents

~~Petitioners~~ also advance the argument, sustained in *Commissioner* v. *Freihofer*, 102 F. (2d) 787, that the definitive event fixing respondents' loss was not the foreclosure sale but the decree of foreclosure which ordered the sale and preceded it. But since the foreclosure contemplated by the decree was foreclosure by sale and the foreclosed property had value which was conclusively established by the sale for the purposes of the foreclosure proceeding, the sale was the definitive event establishing the loss within the meaning and for the purpose of the revenue laws. They are designed for application to the practical affairs of men. The sale, which finally cuts off the interest of the mortgagor and is the means for determining the amount of the deficiency judgment against him is a means